

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CEDARBROOK)	
TREATMENT PLANT FOR A RATE ADJUSTMENT)	CASE NO. 92-327
PURSUANT TO THE ALTERNATIVE RATE)	
FILING PROCEDURE FOR SMALL UTILITIES)	

O R D E R

On August 5, 1992, Cedarbrook Treatment Plant ("Cedarbrook") filed its application for Commission approval of a proposed increase in its rates for sewer service. Commission Staff, having performed a limited financial review of Cedarbrook's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Cedarbrook's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 17th day of November, 1992.

PUBLIC SERVICE COMMISSION

ATTEST:


Executive Director


For the Commission

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STAFF REPORT

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Public Utility Financial
Analyst
Water and Sewer Revenue
Requirements Branch
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Prepared By: Etta Townsend
Public Utility Rate
Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

STAFF REPORT
ON
CEDARBROOK TREATMENT PLANT
CASE NO. 92-327

A. Preface

On August 5, 1992, Cedarbrook Treatment Plant ("Cedarbrook") filed an application with the Commission seeking to increase its sewer rate pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rate would generate approximately \$6,642 annually in additional revenues, an increase of 80 percent over normalized test-year revenues of \$8,262.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Cedarbrook's operations for the test period, calendar year 1991. Carl Salyer Combs of the Commission's Division of Rates and Tariffs conducted the review at Cedarbrook's offices in Lexington, Kentucky on August 28, 1992 and is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by Etta Townsend of the Commission's Research Division. During the course of the review, Cedarbrook was advised that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Cedarbrook be authorized to increase its annual operating revenues by \$6,642.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Cedarbrook reported total test-year operating revenues in the amount of \$8,653. Of this amount, \$8,262 was derived from rates and \$391 from forfeited discounts. Staff is of the opinion that the \$391 from forfeited discounts may not be available in the future. Therefore, an adjustment has been made to operating revenues in that amount. Its application indicates that at the time of filing, Cedarbrook had 54 customers and that they would generate \$8,262 at current rates. Therefore, the total adjusted operating revenue is \$8,262.

Operating and Maintenance Expenses

Cedarbrook reported test-period operating expenses of \$10,341 which it proposed to increase by \$5,675. Staff's adjustments to test-period operations are discussed in the following sections:

Management Fee

Cedarbrook reported no test-year payments for management services. The Commission's past practice has been to allow a management fee for small sewer utilities. In this instance, Staff

is of the opinion that Cedarbrook is entitled to an annual management fee and that \$2,400 is a reasonable level. Therefore, Staff recommends inclusion of an annual management fee of \$2,400 for rate-making purposes.

Sludge Hauling Expense

Cedarbrook reported no test-year sludge hauling expense, but proposed an annual expense of \$875. During the course of the field review, Staff requested that Cedarbrook provide information regarding the number of loads of sludge that would be involved and the cost per load. Subsequently, Cedarbrook provided a letter from Perfect-a-Waste Sewage Equipment Company, its provider of routine maintenance services, stating that 4 to 6 loads per year, at a cost of \$150 per load, would be the expected amount. Based on that information, Staff recommends inclusion of annual sludge hauling expense of \$750¹ for rate-making purposes.

Maintenance of Treatment and Disposal Plant

Cedarbrook proposed to increase reported test-year maintenance of treatment and disposal plant expenses of \$531 by \$4,800 based upon the purchase of 2 pumps at a cost of \$2,200, having tanks and other equipment painted at a cost of \$600, having diffusers replaced at a cost of \$500 and the possible breakdown and repair of equipment estimated to cost \$1,500.

Staff recommends that the two pumps be capitalized and depreciated over an appropriate period. This matter will be

¹ 5 loads x \$150 per load = \$750.

addressed further in a section on depreciation expense. With regard to having tanks and other equipment painted, Cedarbrook's provider of routine maintenance services stated that tanks need painting every 5 years while the other equipment needs painting every 3 years. This matter will be addressed further in a section on amortization expense. With regard to the replacement of diffusers, the Commission's Engineering Division is of the opinion that this would normally be necessary every 3 years. This matter will also be discussed further in the section on amortization expense.

The possible breakdown and repair of equipment does not meet the Commission's known and measurable standard. Therefore, Staff recommends that that portion of the proposed adjustment be denied.

Staff recommends inclusion of annual maintenance of treatment and disposal plant expense of \$531 for rate-making purposes.

Administrative and General Salaries

Cedarbrook reported test-year administrative and general salaries expense of \$222. In a previous section, Staff recommended inclusion of an annual management fee of \$2,400 for rate-making purposes. Since such an allowance has been made, Staff recommends the disallowance of the reported test-year administrative and general salaries expense of \$222 and no such expense has been included for rate-making purposes.

Regulatory Commission Expense

Cedarbrook reported no test-year regulatory commission expense. Cedarbrook's reported test-year taxes other than income tax expense of \$1,664 includes the \$1,500 cost of a permit required by the Kentucky Natural Resources and Environmental Protection Cabinet's Division of Water. The permit covers a period of 5 years which results in a prorated annual expense of \$300. Staff recommends that \$1,500 be excluded from the taxes other than income tax expense account and that annual regulatory commission expense of \$300 be included for rate-making purposes.

Depreciation Expense

Cedarbrook reported test-year depreciation expense of \$903 and proposed no adjustment to that amount. As mentioned previously in the section on maintenance of treatment and disposal plant, a portion of Cedarbrook's proposed adjustment to that expense is based upon the purchase of 2 pumps at a total cost of \$2,200. According to the Commission's Engineering Division, five years is an appropriate period over which to depreciate the pumps. Since Staff recommends that these items be capitalized and depreciated, annual depreciation expense of \$440² related to those items has been included for rate-making purposes. Combined with the aforementioned reported test-year depreciation expense of \$903,

² \$2,200/5 years = \$440 annually.

Staff recommends inclusion of total annual depreciation expense of \$1,343³ for rate-making purposes.

Amortization Expense

Cedarbrook reported no test-year amortization expense. As mentioned previously in the section on maintenance of treatment and disposal plant, a portion of Cedarbrook's proposed adjustment to that expense is based upon having tanks and other equipment painted at a cost of \$600 and having diffusers replaced at a cost of \$500. As the painting of tanks and other equipment will not recur annually, Staff recommends that this expense be amortized over 5 years and has included annual amortization expense of \$120⁴ for rate-making purposes. According to Staff's Engineering Division, replacement of diffusers may be expected to occur every 3 years. Therefore, Staff has included annual amortization expense of \$167⁵ related to the diffusers for rate-making purposes. Combined with the aforementioned recommendation to include annual amortization expense of \$120, Staff recommends inclusion of total annual amortization expense of \$287⁶ for rate-making purposes.

Taxes Other Than Income Tax Expense

Cedarbrook reported test-year taxes other than income tax expense of \$1,664. Of that amount, \$1,500 represents the cost of

³ $\$903 + \$440 = \$1,343.$

⁴ $\$600/5 \text{ years} = \120 annually.

⁵ $\$500/3 \text{ years} = \167 annually.

⁶ $\$120 + \$167 = \$287.$

a required Kentucky Pollutant Discharge Elimination System permit which is in force for 5 years. As explained previously in the section on regulatory commission expense, Staff recommended that the \$1,500 be excluded from the taxes other than income tax expense account and included a prorated annual amount of \$300 in the regulatory commission expense account. Therefore, Staff has included annual taxes other than income tax expense of \$164⁷ for rate-making purposes.

Operations Summary

Based on the recommendations of Staff contained in this report, Cedarbrook's operating statement would appear as follows:

	<u>Test Year Actual</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
OPERATING REVENUES:			
Flat-Rate Revenues	\$ 8,262	\$ -0-	\$ 8,262
Other Oper. Revenues	391	<391>	-0-
Total Oper. Revenues	<u>\$ 8,653</u>	<u>\$ <391></u>	<u>\$ 8,262</u>
OPERATING EXPENSES:			
Management Fee	\$ -0-	\$ 2,400	\$ 2,400
Sludge Hauling	-0-	750	750
Water Service	534	-0-	534
Electric Power	1,320	-0-	1,320
Routine Maintenance	3,776	-0-	3,776
Maintenance of Treatment & Disposal Plant	531	-0-	531
Customer Records and Collection	1,152	-0-	1,152
Admin. & General Salaries	222	<222>	-0-
Office Supplies & Other	239	-0-	239
Regulatory Commission	-0-	300	300
Depreciation	903	440	1,343

⁷ \$1,664 - \$1,500 = \$164.

Amortization	-0-	287	287
Taxes Other Than			
Income Taxes	1,664	<1,500>	164
Total Oper. Expense	<u>\$10,341</u>	<u>\$ 2,455</u>	<u>\$12,796</u>
NET INCOME	<u>\$<1,688></u>	<u>\$ <2,846></u>	<u>\$<4,534></u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operation ratio.⁸

This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has fully, or largely, been recovered through the receipt of contributions, either in the form of grants or donated property. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. Cedarbrook's requested revenue requirement of \$14,904 yields an after-tax operating ratio of 88.04 percent and increased revenues of \$6,642.⁹ Inasmuch as

⁸ Operating Ratio = Operating Expense/Operating Revenue.

⁹ Adjusted Operating Expense/Operating Ratio \$12,796/.8804
Required Operating Revenue Exclusive of
Provision for Income Taxes \$14,534

Required Operating Revenue without Tax
Provision \$14,534
Less: Adjusted Operating Expense <12,796>
Net Operating Income Exclusive of
Provision for Income Taxes \$1,738

Net Operating Income Exclusive of Provision
for Income Taxes/Complement of Composite
Tax Rate \$1,738/.8245
Net Operating Income Inclusive of Provision
for Income Taxes \$2,108

Adjusted Operating Expenses \$12,796


the differential is immaterial, Staff recommends that Cedarbrook's requested increase of \$6,642 be accepted.

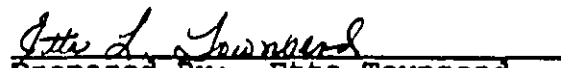
D. Rate Design

Under the existing rate schedule, all residential customers are paying a flat rate.

Using the proposed rate design, Staff has developed rates that will produce \$14,904, the revenue required to meet annual operating expenses. Therefore, Staff recommends that the schedule of rates in Appendix A be approved for services rendered.

E. Signatures


Prepared By: Carl S. Combs
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Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division


Prepared By: Etta Townsend
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

Add: Net Operating Income with Income Tax Provision	2,108
Revenue Requirement Inclusive of Income Tax Provision	<u>\$14,904</u>
Revenue Requirement	\$14,904
Less: Adjusted Test-year Operating Revenues	< 8,262 >
Amount of Increase Required	<u>\$ 6,642</u>

APPENDIX A
TO STAFF REPORT CASE NO. 92-327

The Staff recommends the following rate be prescribed for customers of utility.

<u>Customers Class</u>	<u>Rates</u>
Residential (Single Family)	\$23.00 per month